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# Testimony of the Honorable Brian O'Neill Councilman, Philadelphia, Pennsylvania

*on behalf of*

**The National League of Cities**

*before the*

## National Economic Growth, Natural Resources and Regulatory Affairs' Subcommittee of the House Government Reform and Oversight Committee

*Tuesday, July 28, 1998*

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Good morning, Mr. Chairman, my name is Brian O'Neill. I am a councilmember from Philadelphia-one of the oldest cities in the nation and one of the cradles of our federal system I serve as the President of the National League of Cities, the largest and oldest organization representing municipalities and their elected officials. I am here this morning, with my colleagues, to discuss the relationship between the federal government and state and local governments.

We want to begin by thanking you and the committee for holding this hearing. We believe we are in the midst of fundamental changes affecting the relationship of the federal government to state and local governments. We are grateful to you for your recognition of the importance of this issue-not just to us, but to all Americans. The changes - both those ongoing and pending in the Executive branch, on the Hill, and by regulatory agencies - could have long term impacts on state and local governments. We believe those changes ought not to be premised on a fundamental change in policy direction. We appreciate your interest, and we hope to provide a series of recommendations for changes to rebuild our federal system.

Mr. Chairman, there are some 36,000 thousand cities and towns in the United States. Most have small populations, few professional staff, and small budgets. 91 percent have populations of less than 10,000. This is a time of great change for all of them. The fiscal trends are significant with consequences for the future. For the most part, the current changes involve the assumption of significantly greater responsibilities - offloaded from the federal government - and significant federal preemption threats to historic and traditional local fiscal, land use and zoning authority.

We are in the middle of enormous and rapid changes in the federal-state-local relationships with long-term consequences for the nation's cities. The changes, if anything, are re-emphasized by the President's Executive Order on Federalism and concurrent proposal to revoke two earlier Executive Orders that we were involved in putting together. They are highlighted by legislation in the Senate Finance Committee this morning to interfere with the rights of states and local governments to regulate and tax sales and services provided over the Internet as comparable sales and services are taxed-but the limitations would not apply to the federal government. They are emphasized by the House action last week to preempt state and local authority to challenge securities fraud in state courts and the action in the Commerce Committee around the corner to preempt local authority with regard to the siting of towers and antennas on federal property. In no instance have we been invited to the table even though the most significant impacts will be felt at home.

For that reason, this morning we join the nation's governors and leaders of other national organizations representing state and local elected leaders in requesting the rescinding of the new Executive Order on Federalism. We urge this action to provide adequate time for meaningful consultations with our levels of government with regard to proposed changes that were made with no prior consultation, notice, or warning. We believe the changes and the manner in which they were made raise serious questions with regard to the Administration's perceptions of the balances of power between the three levels of government. Before revoking the two previous Executive Orders, we urge consultation with leaders of the organizations of state and local

elected officials. We make this request because we believe the new changes give an entirely different and inappropriate thrust to federalism as guidance to executive branch officials.

We believe this hearing this morning marks an important opportunity to broaden this **dialogue**—so that it includes the Congress as well as the administration. For, while the Congress does not have the authority to issue Executive Orders, it does have the authority to recommend and pass laws that have the effect of preempting historic and traditional rights and authority of the nation's state and local governments. Therefore, we would hope that today could be the start of a genuine commitment to mutual respect between our three levels of government.

Last March we overwhelmingly adopted halting the new trend of major federal preemption of historic and traditional state and local roles and responsibilities as our highest priority. The proposed executive order revokes all references to this key issue. In contrast, the new order proposes a renewed preeminence of the federal government with an emphasis on mandating uniformity. It focuses on nine reasons for this reversal of more than two decades of federal policy and deference to state and local authority. This morning ought to be a good opportunity to begin—all of **us**—to commence a serious effort to restoring authority to the levels of government closest to the people.

It has become increasingly clear that despite White House and Congressional claims of an intent to turn back greater power and authority to the level of government closest to the people, those words bear less and less relationship to actions. The preemption or taking away of historic and essential authority of local governments over activities such as franchising, zoning, taxing, and regulating—fundamental responsibilities of state and local governments for the protection of public health, safety and property is less important to larger corporate and federal interests than uniformity and the elimination of state and local rules, laws, fees, and taxes.

Pending proposed federal preemptions, if adopted as a regulation or enacted as a new federal law, will have far-reaching consequences and impose greater liabilities on cities and towns. They would curtail the rights of citizens in cities and towns to make the key decisions about the future of their own communities.

No issue in 1998 is likely to more affect the bottom line for local budgets and services, and for the rights of citizens in cities and towns across the nation than federal efforts to preempt historic and traditional municipal authority. This is an issue city leaders will confront in the federal courts, the Congress, the Administration, and at independent federal regulatory agencies. Preemption of local authority is not just a measure that Congress and the Administration seem interested in pursuing. Federal agencies, such as the Federal Communications Commission (FCC), are also, at the request of industry, proposing rules—often under intense pressure from Congress and industry—which seek to limit local authority over the siting of cellular and broadcast towers.

The key aspects of the current status of federalism are:

- the trends away from federal grants to local governments and shifting to direct payments to individuals - either through entitlement benefits or tax expenditures. The federal government is making the decisions about what is in the best interest of the citizens of a community.
- there is an ongoing significant decline in federal capital investment at the local level. The disinvestment as a percent of the federal budget is aggravated by Congressional legislative threats to the ability of states and local governments to finance public capital investment through tax-exempt municipal bonds.
- the portion of the federal budget going to entitlement spending is consuming ever greater proportions, leaving less and less of the budget to invest in the nation's future. As the U.S. competes in the fields of technology and information in the global economy, disinvestment in the next generation will be reflected in local economies.
- the proportion of the federal budget going towards the elderly is leaving less and less to invest in the next generation. With juvenile crime in cities at high levels, and the nation's local economies facing major demographic shifts, disinvestment in kids could have severe consequences for the nation's cities' economies.
- while local governments have traditionally been responsible for bricks and mortar, as well as public safety; federal actions to reduce federal responsibility and liability for welfare recipients, immigrants, and public housing tenants leave an ever-increasing liability on local governments. Increasingly, the burden transfer will aggravate disparities between local governments.
- while the trend in imposing direct federal, unfunded mandates is clearly on the decline, there has been an unprecedented increase in federal efforts to preempt state and local tax and revenue authority, threatening to undercut state and local revenue systems as we know them. Pending efforts in the Congress on takings, preempting state and local authority to levy or collect existing taxes and revenues on goods and services provided over the Internet, preempting local authority with regard to the siting of group homes, and proposals on telecommunications, federal tax reform, railroad safety, and electric utility deregulation all would have harsh consequences on municipal authority and revenues.

## **Federalism**

What brings us here this morning is a Presidential order to alter fundamentally the relationship of the federal government and state and local governments. The Executive Order on Federalism, #13083, issued by President Clinton, would rewrite the distribution and balance of power away from the direction established under the last three Presidencies. It would set the federal

government and its many agencies that affect cities and towns on a very different policy course--revoking earlier commitments to oppose unfunded federal mandates and federal preemption, and replacing them with expanded guidelines and justifications for preempting historic and traditional municipal authority.

We believe the new Executive Order calls into question fundamental principles of federalism. We are concerned that all references to the Tenth Amendment, identification of new costs or burdens, and reduction of mandates are revoked. Part of the greatness of federalism has been the flexibility of our great system to allow any city, county, or state to develop new ideas and approaches to confront problems affecting Americans- the laboratory of democracy and the will of the people at each level of government in America. Through that model we have well served all our citizens. The tradition and spirit of federalism ought to-especially on this of all issues-lead us to work together to shape and reshape the future of our country and our traditional relationships. We stand ready and look forward to an opportunity to do just that--together.

Unlike previous federalism Executive Orders, the new order, signed by President Clinton while he was in Manchester, England, would revoke both former President Reagan's Executive Order on Federalism, as well as an earlier Order by President Clinton in 1993. Similarly, unlike the two previous orders which were put together only after extensive consultation with state and local leaders, there was no consultation at all on the pending order. Nor is there any explanation for the unprecedented efforts to eliminate Presidential directives with regard to unfunded mandates and preemption. The President's own previous Executive Order called for more cost analysis and risk assessments for all government regulations, recognizing that federal actions can and do impose significant costs and liabilities on states and local governments. Those cost analyses and risk assessments would now, apparently, be abolished.

While an Executive Order is different than a federal law and carries no endorsement from the Congress, it provides direction from the President of the United States to all Cabinet agencies and departments. In this instance, once the new order were to go into effect, it would provide new guidelines for all federal officials to consider in determining when a rule, regulation, or law had "federalism implications." That is, the order will create direction for federal bureaucrats about how to address issues of municipal sovereignty, and when and under what circumstances it will be okay to preempt traditional municipal authority and responsibilities. Each of the three Executive Orders are about setting guidelines for when and how it is appropriate for the federal government to intrude upon or interfere with state or local authority.

The new proposal emphasizes the justification for federal action on matters of national or multi-state scope. It would eliminate previous references to the 10<sup>th</sup> Amendment-the key amendment reserving to states the rights not expressly delegated by the Constitution to the federal government. The contrast between the revoked orders and the new order is most significant with regard to the fundamental principles of federalism. Where the order originally issued by former

President Reagan focused on the preservation of state and local authority, the new proposal focuses on the supremacy of the federal government. Perhaps the most telling difference between the new version and the earlier two is the insistence upon an expanded list of situations where federal action is justified, including the:

- need for uniform national standards;
- reluctance of state and local governments to impose necessary regulations themselves for fear of business relocation;
- increased costs to governments because of decentralization;
- compliance with international treaties and other agreements; and
- excessive costs of specialized expertise which would put the costs of regulation beyond the capacity of state and local governments.

## **Recommendations**

We would hope that as an outcome of this set of hearings, the committee would consider the following recommendations:

- a moratorium on new federal preemptions by the House and Senate.
- the adoption of legislation to require a fiscal impact analysis on all federal legislation and federal regulations, including regulations from independent agencies such as the Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the Internal Revenue Service, on states and local governments.
- the introduction of a federal Preemption Relief Act, to act as a follow-up to the Unfunded mandates reform Act of 1995.
- the issuance of a joint report on generation fiscal concerns and disparities and their implications for the federal system.

## **Background**

As cities have realized an ever smaller share of their budgets from federal grants-in-aid, the importance of the health of local economies has increased. Today, cities realize the greatest portion of their revenues to balance their budgets from local taxes and fees. It is, in large part, for that reason that balancing the federal budget and controlling federal entitlement spending have been our highest federal priorities for the last five years. We have worked especially closely with the National Conference of State Legislatures on both fronts. Spending less to pay interest on the national debt and more to prepare for tomorrow has been a guiding policy of the organization.

In some ways, the decision in the budget seems part and parcel of the growing tendency in Washington, D.C. to take away the authority of state and local leaders to make decisions that reflect the will and interest of the citizens they represent - that somehow federal officials know far better what is in the best interests of citizens in a community than their own local leaders.

Last July, the NLC Board of Directors adopted a motion to carry out a study of federal spending trends, the changing economy and demographics, and emerging economic disparities. The action came after a major discussion by the Board with regard to the impact of federal fiscal policies and their impact on disparities in the nation's cities. The Board also provided input to a joint initiative with the National Governors' Association and the National Conference of State Legislatures to examine emerging trends affecting state and local revenues.

The nation is witnessing totally new emerging technologies transforming the country and its cities - perhaps in ways totally different than in previous cycles. These changes have implications for state and local revenues as they radically redefine old concepts of nexus, and as the economy moves to the future against a backdrop of state and local tax systems adopted for another era. Because today's new technologies are not as capital-intensive, or labor-intensive, or heavily industrial as the ones which used to drive the American economy, NLC adopted a proposal to create a joint endeavor with the National Governors' Association (NGA) and the National Conference of State Legislatures (NCSL) to produce a report intended to provide information to elected state and local leaders about the changing nature of the national economy, with an analysis of the potential impacts on state and local revenues and the flexibility of current structural capacities to respond to these changes. We are following up this year with a new report looking at the impact of the global economy, deregulation, and information technology on the structure of state and local governments.

Economic, technological, telecommunication, demographic, and legislative changes are altering the federal system, perhaps beyond recognition. Our purpose last year was to examine the equity and responsiveness to changes in the economy of State and local revenue systems in today's global economy. What are the factors eroding state and local authority: federal pressure, changing demographics, globalization of the economy? Designed during the smokestack age, are state and local tax systems obsolete, inequitable, and unresponsive to changes in the economy? Have changes in the American economy, the population, and federal policies undercut the ability of states and local governments to assume greater demands and ensure equity in their revenue systems?

The most significant fiscal trend over the past twenty years has been the declining share of federal support to state and local governments, which has placed a much greater burden on current state and local taxes. Federal grants-in-aid to state and local governments averaged 21.5 percent of their total spending over the 1990-95 period. This is well below the 26.5 percent peak that occurred in 1978. Consequently, state and local governments have had to rely much more on their own tax revenue sources to generate sufficient revenue to provide services required by the public. Further,

the recent trend of Congress pushing more responsibilities to state and local governments will place additional burdens on the current state-local tax structure.

. *Deregulation of the telecommunications and electric industries.* Allowing competitive entry in these regulated industries will force state and local governments to experience substantial tax shifting. Substantial hardship is expected for taxing jurisdictions that rely heavily upon existing electric generating facilities to pay local property taxes.

• *Federal tax reform.* Congressional proposals for a flat tax and a national retail sales tax would force states to undertake major revisions of their sales and personal income tax systems. Both proposals would eliminate state and municipal authority to issue tax-exempt municipal bonds-affecting more than \$1 trillion in outstanding bonds used to finance virtually every school, jail, road, airport, and bridge in the nation. It would be difficult to overstate the havoc caused to the state-local tax structure if federal tax law eliminated deductions for mortgage interest, state personal income taxes, and local property taxes.

We are grateful for the opportunity to be here with you today to share our views that stem from discussions and commitments made more than 200 years ago in my city. Perhaps we ought to reconvene. We certainly believe a concerted, bipartisan effort is critical if we are to be credible in our efforts to make the government of the next century effective, efficient, and responsive to our joint constituents,

Thank you. I would be pleased to respond to any questions.



# State & Local Preemption

ISSUES	LOCAL PREEMPTION	STATE & LOCAL IMPACT
<b>FINANCE &amp; ADMINISTRATION</b>		
Takings	<ul style="list-style-type: none"> <li>Legislation would allow developers to pursue takings claims in federal court without first exhausting state judicial procedures.</li> </ul>	<ul style="list-style-type: none"> <li>Would result in far greater federal court involvement in local land use disputes. Would interfere with the resolution of essentially state and local issues within the state court system. Would encourage developers to bring suits in federal court, rather than work out their disputes with local governments.</li> </ul>
Bank Powers	<ul style="list-style-type: none"> <li>Legislation would render state legislative authority to determine state bank powers null and void.</li> </ul>	<ul style="list-style-type: none"> <li>Could create unlevel playing field for bank branches depending upon their state of chartering - rather than the state law where they are conducting business. Could create some competitive disadvantages for home-based state-chartered banks.</li> </ul>
State Securities Regulation	<ul style="list-style-type: none"> <li>Preempt ability of state and local governments to challenge securities fraud in state court and preempt requirement for securities dealers to make only suitable investment recommendations to pension funds and state and local governments.</li> </ul>	<ul style="list-style-type: none"> <li>Would remove current legal rights to suitable investment advice and right to recover damages for fraud from securities dealers.</li> </ul>
<b>COMMUNITY &amp; ECONOMIC DEVELOPMENT</b>		
Municipal Annexation	<ul style="list-style-type: none"> <li>The consolidated Farm and Rural Development Act of 1961 preempts state and local governments from providing a full range of infrastructure and services in an annexed area if a rural utility service has a protected federal loan or loan guarantee on a facility in the area.</li> </ul>	<ul style="list-style-type: none"> <li>This makes it difficult for localities to carry out growth and economic development plans under state law.</li> </ul>
Homedwnership Campaign	<ul style="list-style-type: none"> <li>The National Conference of States on Building Codes and Standards (NCSBCS) claims that the cost and effectiveness of laws that regulate the construction of residential, commercial, public and factory buildings make building too costly. As part of HUD's Homeownership Partnership, NCSBCS is leading a working partnership to set preemptive, national building and regulatory process.</li> </ul>	<ul style="list-style-type: none"> <li>The goal is to achieve up to a 60 percent reduction in the state and local land use, zoning and permit regulatory authority. This would preempt historic and traditional state and local responsibilities in the areas of land use, zoning and building codes. However, there has been little progress with this initiative.</li> </ul>
Fair Housing Zoning Authority	<ul style="list-style-type: none"> <li>Current law preempts municipal authority over the siting of group homes.</li> </ul>	<ul style="list-style-type: none"> <li>Leads to federal investigations and actions when city refuses permit for group home siting.</li> </ul>

## **PUBLIC SAFETY**

Juvenile Justice	Federalization of certain juvenile crimes.	Threatens state and local authority regarding punishment for crimes. Would allow federal and state prosecutors unprecedented opportunities to circumvent state law.
Natural Disaster Insurance	In the name of disaster mitigation, the Federal Emergency Management Agency and the insurance industry are considering requiring in federal legislation the creation and enforcement of building codes which will reduce loss of life and physical damage resulting from catastrophic natural disasters.	Would mandate that localities pass and enforce certain building standards, notwithstanding state law.

## **TRANSPORTATION & COMMUNICATIONS**

Railroads	<ul style="list-style-type: none"> <li>Under the ICC Termination Act, cities and towns have been preempted from zoning authority and implementation of environment, health and safety statutes.</li> </ul>	<ul style="list-style-type: none"> <li>Does not allow local governments to carry out local laws in relation to railroad company decisions.</li> </ul>
Tow Truck Regulation	<ul style="list-style-type: none"> <li>Under the ICC Termination Act, municipalities were told what they could regulate in relation to tow trucks.</li> </ul>	<ul style="list-style-type: none"> <li>Courts in CA and TX have ruled that municipalities can only regulate those activities specified under the ICC Act.</li> </ul>
Telecommunications	<ul style="list-style-type: none"> <li>Preempts local taxes on broadcast satellite services.</li> </ul>	<ul style="list-style-type: none"> <li>Would force higher taxes and fees on all other businesses and residents.</li> </ul>
Taxing Authority (A)		
Taxing Authority (B)	<ul style="list-style-type: none"> <li>Congressional proposals to preempt state and local taxes and fees on Internet transactions.</li> </ul>	<ul style="list-style-type: none"> <li>Would force higher taxes and fees on all other businesses and residents.</li> </ul>
Zoning Authority: Cellular Towers	<ul style="list-style-type: none"> <li>Industry petition before the FCC that would preempt state and local authority over the siting of cellular towers and broadcast transmission facilities. Bipartisan House and Senate leaders set to introduce NLC-supported bill to give cities greater siting authority.</li> </ul>	<ul style="list-style-type: none"> <li>Would lose ability to make land use and zoning decisions, to preserve the integrity of local neighborhoods, protect property values, protect public health and safety.</li> </ul>
Zoning Authority: Satellite Dishes	<ul style="list-style-type: none"> <li>FCC rule preempting local ordinances that restrict the use of broadcast satellite antennas.</li> </ul>	<ul style="list-style-type: none"> <li>Interferes with local ability under state law to ensure that the siting of antennas is safe, consistent with traditional zoning, height and land use practices.</li> </ul>

## **ENERGY, ENVIRONMENT, AND NATURAL RESOURCES**

Electric Utility Deregulation	<ul style="list-style-type: none"> <li>Legislation potentially jeopardizes state and local authority in many areas, including control over the public rights-of-way</li> </ul>	<ul style="list-style-type: none"> <li>State and local governments could lose policymaking and revenue-raising capacity. Would lose ability to make decisions regarding the use of public streets, lose compensation in the way of franchise fees.</li> </ul>
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